

AND THE SURVEY SAYS... THE EFFECTIVENESS OF DOD OUTSOURCING AND PRIVATIZATION EFFORTS

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The Department of Defense (DoD) is implementing a Revolution in Business Affairs (RBA) with the purpose of freeing resources for the Revolution in Military Affairs (RMA). The goal of the RBA is to transform how DoD conducts business. As part of this RBA, DoD has undertaken outsourcing studies using the Office of Management and Budget (OMB) Circular A-76 and related initiatives. The objective of these initiatives is to generate the cost savings needed to fuel the RMA. Initial results have fallen short; clearly there are challenges facing DoD in the attainment of its goals.

***“We must put strategy first, then spending.
Our defense vision will drive our defense budget,
not the other way around.”***

— President George W. Bush

As the 2000–2001 Defense Acquisition University Military Research Fellows, we were provided a research topic, “Effectiveness of DoD’s Implementation of Outsourcing, Privatization, and Commercial Acquisition Practices.” This topic was indeed broad. We considered several narrow areas upon which to concentrate. However, our early

research efforts and exposure to the formulation and execution of business strategies while attending a Harvard Business School executive education program led us to focus on the over-arching business strategy of a corporation.

The more we studied this topic, the more we were intrigued and the more parallels we were able to draw between the corpo-

Report Documentation Page				Form Approved OMB No. 0704-0188	
Public reporting burden for the collection of information is estimated to average 1 hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to Washington Headquarters Services, Directorate for Information Operations and Reports, 1215 Jefferson Davis Highway, Suite 1204, Arlington VA 22202-4302. Respondents should be aware that notwithstanding any other provision of law, no person shall be subject to a penalty for failing to comply with a collection of information if it does not display a currently valid OMB control number.					
1. REPORT DATE 2002		2. REPORT TYPE		3. DATES COVERED 00-00-2002 to 00-00-2002	
4. TITLE AND SUBTITLE And the Survey Says...The Effectiveness of DOD Outsourcing and Privatization Efforts				5a. CONTRACT NUMBER	
				5b. GRANT NUMBER	
				5c. PROGRAM ELEMENT NUMBER	
6. AUTHOR(S)				5d. PROJECT NUMBER	
				5e. TASK NUMBER	
				5f. WORK UNIT NUMBER	
7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES) Ballistic Missile Defense Organization, Washington, DC, 20301				8. PERFORMING ORGANIZATION REPORT NUMBER	
9. SPONSORING/MONITORING AGENCY NAME(S) AND ADDRESS(ES)				10. SPONSOR/MONITOR'S ACRONYM(S)	
				11. SPONSOR/MONITOR'S REPORT NUMBER(S)	
12. DISTRIBUTION/AVAILABILITY STATEMENT Approved for public release; distribution unlimited					
13. SUPPLEMENTARY NOTES Acquisition Review Quarterly, Spring 2002					
14. ABSTRACT					
15. SUBJECT TERMS					
16. SECURITY CLASSIFICATION OF:			17. LIMITATION OF ABSTRACT Same as Report (SAR)	18. NUMBER OF PAGES 14	19a. NAME OF RESPONSIBLE PERSON
a. REPORT unclassified	b. ABSTRACT unclassified	c. THIS PAGE unclassified			

rate world and business functions within the Department of Defense (DoD). The application of business strategy methodologies represented a valuable analytical tool with which DoD could examine some of the vexing problems it now faces to include outsourcing and privatization.

In addition to the examination of current business literature, we developed and administered a survey to a sample of DoD personnel. This was done in order to gauge attitudes and impressions of current outsourcing initiatives. We did this because we could find no evidence that anyone had attempted to gather such feedback on a Department-wide basis. The results were quite striking.

This article goes through our initial findings, research hypothesis and approach spurred by these early findings, the subsequent survey methodology, and the significant results drawn from the survey responses. The final report, "From Chaos to Clarity: How Cost-Based Strategies are Undermining the Department of Defense," is available online at <http://www.dsmc.dau.mil/pubs/misc/clarity.htm>.

INITIAL FINDINGS

During our initial interviews and literature research it became quite apparent that the strategy behind the Office of Management and Budget (OMB) A-76 and strategic sourcing initiatives is cost-savings in response to limited resources stemming from dramatic increases in non-discretionary spending. This category of spending includes entitlement programs such as Medicare, social welfare programs, and payment on the national debt.

Unlike discretionary spending, these accounts are not part of the annual Congressional appropriations process. These accounts pay automatically and their growth is squeezing discretionary accounts, such as defense accounts, that are subject to annual appropriations. In 1965, discretionary spending accounted for 35 percent of federal outlays. By 1990, it had risen to 60 percent of federal outlays (Ippolito, 1994). This figure is projected to reach 63 percent in 2000 and rise to 74 percent by 2010 (Congressional Budget Office, 2000). Despite funding supplements, federal agencies will continue to fight for a dwindling slice of discretionary dollars and, as the slice of defense spending declines, the battle then carries over to an internal struggle within DoD.

The effects of monetary and contingency pressures are becoming apparent in terms of aging equipment and increasing maintenance costs. This phenomenon is so prevalent throughout DoD it has become known as the "death spiral." Clearly, future defense readiness will continue to decline as long as modernization dollars are limited and equipment continues to age, requiring increased maintenance (see Figure 1). More resources are required, yet increases in top line defense spending are neither likely nor sufficient.

Change is imperative and DoD senior officials see outsourcing as a means toward cost *savings* to fuel the modernization. This cost-based strategy appeared reasonable on the surface, so we began to review the business landscape to determine how the commercial sector is using outsourcing.

The business world is rapidly increasing its use of outsourcing. This increase is driven by the expanding demands of the

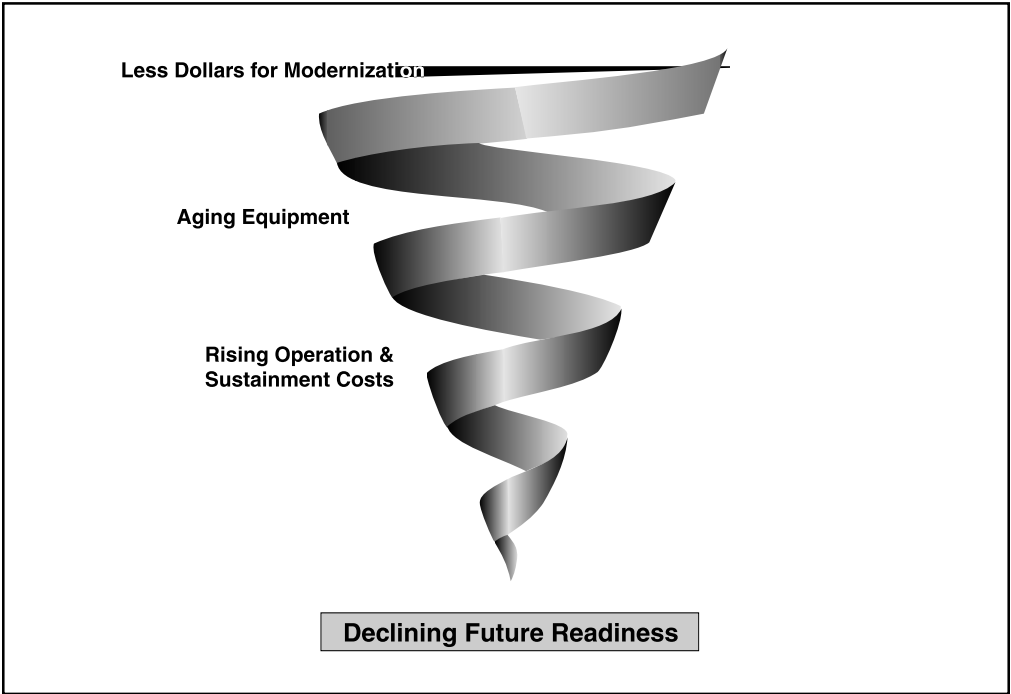


Figure 1. Readiness Death Spiral

evolving Information Economy. According to the most recent Dun & Bradstreet (2000) Barometer of Global Outsourcing report, outsourcing expenditures would surpass the \$1 trillion mark at the end of 2000, becoming “one of the few business

activities to ever reach this level of annual expenditure” (p.1). In fact, global outsourcing has nearly doubled in the past three years, growing at an average of 25 percent a year (see Figure 2).

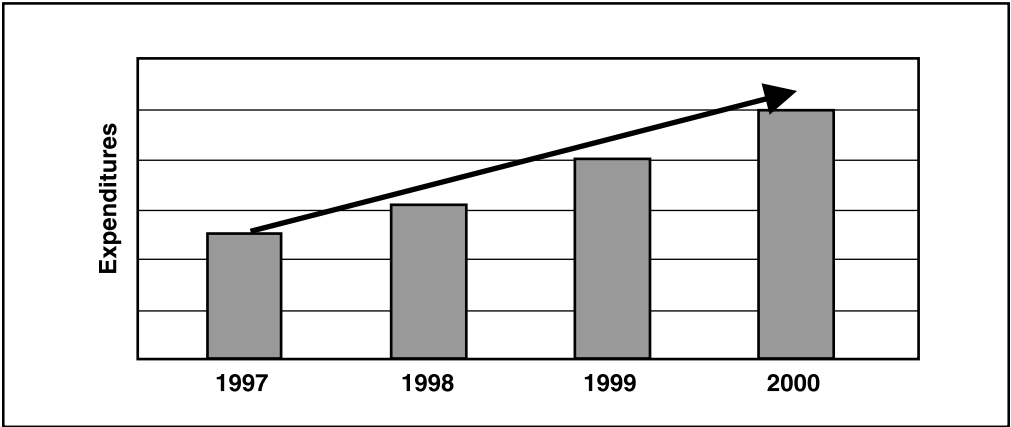


Figure 2. Global Outsourcing Growth

Yet, the reason for this explosive growth goes much further than cost savings. The growth is fueled by the real potential of a complete transformation of the business. The commercial sector has realized the question is not about “how to do things more efficiently.” Outsourcing has become a powerful management tool that forces one to reconsider “what to do.” The commercial sector’s experience with outsourcing over the past 10 years has shown that it has evolved to the point that it can fundamentally redefine a business —

- What the business is,
- What its objectives are,
- How it defines results,
- Who its customers are, and
- What the customers value and pay for (Drucker, 2001).

The decision on which outsourcing strategy to pursue is dependent on the firm’s *vision* of where it wants to be positioned in the future. Whether you seek efficiencies, more focus onto the core business, or whether you want to change the business altogether (see Figure 3).

That vision of where you want the business to be is then captured within a business strategy that seizes upon the unique resources from which a firm or organization obtains and retains its competitive advantage. According to Peter Drucker (2001), strategy converts the firm’s theory of the business into performance. Given that DoD has initiated an RBA to *transform* the way DoD conducts business, we felt the critical research questions are:

- What is the right business strategy for DoD?
- How should DoD pursue outsourcing given that strategy?

RESEARCH HYPOTHESIS AND APPROACH

From these questions, we developed our hypothesis and approach for tackling the research topic. The purpose of the study was to provide an analytical framework for examining DoD from a corporate perspective. With that corporate framework, we hypothesized that an outsourcing approach could be developed consistent with a DoD corporate strategy, benefiting DoD across the spectrum of DoD-wide, regional, and base level activities. We then

Outsourcing	Strategy	Objective
	Tactical	Seeking efficiency
	Strategic	Seeking focus
	Transformation	Seeking change

Figure 3. Outsourcing Objectives

tested the hypothesis by answering these questions:

- Does transformation urgency exist?
- Do DoD outsourcing initiatives align with DoD's business strategy?
- Has the A-76 process generated the results expected?
- Have Strategic Sourcing initiatives generated the results expected?
- Have shortfalls resulted from execution problems or are they strategy related?
- What are the benefits of a new corporate strategy approach?
- Can such an approach be implemented?

Of course, the answers to these questions would come from literature searches, interviews with leading DoD and commercial outsourcing experts, and DoD and commercial outsourcing participants. However, we soon came to realize no one in DoD had conducted a survey of DoD outsourcing participants. We knew that this information was vital to answering the first two questions: "Does a transformation urgency exist?" and "Do DoD outsourcing initiatives align with DoD's business strategy?" Fortunately for us, we were able to find commercial outsourcing surveys from which to author a meaningful DoD survey.

SURVEY METHODOLOGY

The survey instrument was designed based on the *Outsourcing Justification*

Practices study conducted by Pretium Partners, Inc. (2000) in partnership with the Fisher College of Business at The Ohio State University and Michael F. Corbett & Associates. The Pretium study focused on determining and understanding the factors involved in justifying outsourcing decisions, including the tangible and intangible benefits of outsourcing. The study surveyed a random sampling of U.S. and Canadian companies with \$1 billion or more in annual revenue. More than 60 companies responded with detailed information. Our outsourcing survey was modeled after this study in order to facilitate a comparison of the results.

"The Pretium study focused on determining and understanding the factors involved in justifying outsourcing decisions...."

The survey was sent to over 1,300 members in the Department of the Air Force, Department of the Army, Defense Logistics Agency (DLA), and Department of the Navy. We received over 230 responses, about an 18 percent response rate. For the Air Force and Army, the survey was sent to personnel that are or may be involved in outsourcing initiatives. In the Air Force, the survey was sent to the A-76 Commercial Activity program managers and to Air Force base and group commanders. Likewise, all garrison and deputy garrison commanders in the Army were specifically targeted.

On the other hand, a completely random sampling was taken from the DLA and Department of the Navy, using the DLA e-mail directory and Navy/Marine Corps White Pages, respectively. Although

random, command billets were targeted in the Navy and Marine Corps. By targeting command and supervisory positions, we were aiming at determining whether the sense of urgency had reached mid-level managers sufficiently to effect change and whether the linkages between DoD corporate strategy and lower-level strategies existed.

SURVEY FINDINGS:

"THE GOOD, THE BAD, AND THE UGLY"

THE GOOD

In his book, *John P. Kotter on What Leaders Really Do*, Kotter (1999) examines the role of leadership in bringing about successful change in an organization. He lists some common mistakes made by senior leaders that prevent an organization from transforming. Error number one is not establishing a great enough sense of urgency. Based on his research, Kotter believes the urgency rate is sufficient to

effect change when about 75 percent of an organization's management is convinced that "business-as-usual is totally unacceptable"

"The sample consisted of 240 contracts identified with the necessary data to test the four hypotheses."

(1999, p. 79).

Based on our survey results, there is a strong sense that transformation does need to occur and that business as usual is unacceptable. In the survey, we asked the question regarding the need for change. Of the 232 who responded to this question, 87 percent responded, "Yes." For the

111 respondents that identified themselves as being in a command position, the percentage responding "yes" to this question rose to 91 percent. Using this figure as a benchmark, it seems clear that the stage is set for a transformation in the way DoD operates its business functions.

THE BAD

Yet, the survey responses suggested DoD might not harness this sense of urgency since coalition is perhaps lacking. In *Leading Change*, John Kotter (1996) points out that one of the reasons firms' fail is they do not create a sufficiently powerful guiding coalition. Successful firms set a vision, captured in the firm's corporate strategy, that becomes the guidepost for transformation.

The corporate strategy of DoD is found in Appendix I of the 2001 Annual Defense Report (DoD, 2001). Sixty-four percent of the 232 survey respondents and 66 percent of the 111 commanders surveyed regarding DoD corporate strategy have not read it. If key personnel within DoD, who are critical to successful change, have not even read that strategy, it is not possible to achieve coordination or instill commitment.

THE UGLY

Furthermore, if the change vehicle is the A-76 process or strategic sourcing, these data indicate no coalition is possible, at least no majority coalition. Fifty-three percent of the survey respondents disagreed or strongly disagreed DoD was headed in the right direction with respect to outsourcing (see Table 1). Similarly, for the 41 respondents who identified themselves to be in staff/policy positions, 54 percent disagreed or strongly disagreed.

Table 1. DoD Attitudes toward Outsourcing Policy

DoD Is Headed in the Right Direction with Respect to Outsourcing Issues (All Respondents)	
Strongly Agree	3%
Agree	27%
Neither Agree nor Disagree	18%
Disagree	35%
Strongly Disagree	18%
NOTE: Total may not add to 100% due to rounding error.	

In our analysis we could find no one group where a majority of respondents strongly agreed or agreed with this statement. The closest category consisted of the 10 respondents who identified their area of expertise as budget/finance. Of this group, three people agreed DoD was headed in the right direction with respect to outsourcing. None in this category strongly agreed with the statement.

If these data are representative, it's quite remarkable that DoD is aggressively pursuing outsourcing policies that so many disagree with. More striking still are the 111 respondents in positions of command. Of this group, 57 percent either disagree

or strongly disagree that DoD is headed in the right direction with regard to outsourcing. Their responses are shown in Table 2.

Continuing this line of analysis, we looked at the 78 respondents in positions of command who have been involved in an outsourcing effort. Their attitudes are even more pronounced. Of this group, 64 percent disagree or strongly disagree that DoD is headed in the right direction regarding outsourcing initiatives (see Table 3).

While we are in no way stating that installation commanders are not executing outsourcing policy based on these personal

Table 2. Commanders' Attitudes toward DoD Outsourcing Policy

DoD Is Headed in the Right Direction with Respect to Outsourcing Issues (Commanders' Responses)	
Strongly Agree	4%
Agree	24%
Neither Agree nor Disagree	15%
Disagree	33%
Strongly Disagree	23%
NOTE: Total may not add to 100% due to rounding error.	

Table 3.
Attitudes of Commanders Who Have Undergone Outsourcing

DoD Is Headed in the Right Direction with Respect to Outsourcing Issues (Responses of Commanders Who Have Outsourced)	
Strongly Agree	4%
Agree	17%
Neither Agree nor Disagree	15%
Disagree	39%
Strongly Disagree	26%
NOTE: Total may not add to 100% due to rounding error.	

assessments, it should be noted they are concerned about these issues and their concern rises markedly after they have gone through the experience of outsourcing in its current form. At the very least, their feedback is worth gathering and assessing. While comments offered on a survey administered to a random sample of DoD personnel are not well suited for the type of broad feedback needed, we list some of the comments submitted by installation commanders.

- Military forces must always be EFFEC-TIVE on the battle[field] and we are building organizations that are designed to be most EFFICIENT [sic] during peacetime.
- The only outsourcing issue I have had personal experience with is A-76. It is a terrible process.
- I am not sure where DoD is heading quite frankly...and rules, regulations, etc. thus far have only made waters murkier.

- It appears as though few consider the broader strategic impact of changes done in isolated areas.

- I think we need to cut this BS out!

Based on our initial research efforts, these survey responses were not surprising. The level of disagreement was. We suspected that a sense of urgency for change did exist and that the reason behind the inconclusive results from DoD outsourcing efforts stemmed from a strategy perspective. Thus, the basis for our second question, "Do DoD outsourcing initiatives align with DoD's business strategy?"

Our analysis showed us the link from the national military strategy to DoD corporate strategy existed. The question remained, does the strategy behind outsourcing link as one progresses down the organizational layers of DoD and the Services? The survey responses of the approximate 130 individuals who have undertaken an outsourcing effort indicate the outsourcing initiatives currently underway may not be aligned to a common vision and there may not be a linkage

Table 4.
Outsourcing Initiative Alignment to Corporate Strategy

DoD Is Headed in the Right Direction with Respect to Outsourcing Issues (Responses of Commanders Who Have Outsourced)	
	Yes
DoD corporate strategy	42%
Your Service or agency's strategy	66%
Your major command's strategy	67%
Your unit's strategy	38%
Your function or department's strategy	36%

between the organizational levels of DoD (see Table 4).

In addition to examining the linkage of strategy, we sought further information on the validity of a cost-based strategy. Our early research indicated strategy must be aligned to the core beliefs of an organization. For DoD, that belief has historically been focused on the best people, the best equipment, and the best training. The next question to examine was the effect

on this core belief of a cost-based strategy that was being executed primarily through personnel cuts.

When asked which issues are important considerations when conducting an outsourcing study, impact on mission performance and impact on personnel were cited as considerations that ranked above impact on cost. These data are displayed in Table 5.

Table 5.
**Importance Attributed by DoD Personnel
Regarding Impact of Outsourcing**

Which of the Following Issues Are Important Considerations when Conducting an Outsourcing Study?			
	Impact on Cost	Impact on Personnel	Impact on Mission Performance
Strongly Agree	37%	58%	77%
Agree	51%	33%	19%
Neither Agree nor Disagree	6%	4%	0.9%
Disagree	4%	3%	0.4%
Strongly Disagree	2%	2%	2%
NOTE: Total may not add to 100% due to rounding error.			

Respondents were free to indicate that all ranked the same (i.e., respondents could strongly agree with all three) or to differentiate. Note that 97 percent of the 233 people who responded to this question either strongly agreed or agreed that impact on mission performance was an important consideration. Ninety-one percent of those same respondents either agreed or strongly agreed that impact on personnel was an important consideration.

Compare this to 88 percent of respondents that either agreed or strongly agreed that impact on cost was an important consideration. By contrast, when asked what the most important objectives of outsourcing are, the most often cited response was cost control or cost savings. It would seem that Department personnel understand that outsourcing is being initiated to reduce and control cost but, as these data demonstrate, members of DoD view mission and personnel as more important considerations.

This trend was more pronounced among those 111 respondents who identified themselves as being in a command position. Table 6 shows this group broken out separately.

Within this group, 98 percent either strongly agreed or agreed that impact on mission performance is an important consideration, 91 percent strongly agreed or agreed that impact on personnel is important, and 85 percent strongly agreed or agreed that impact on cost is an important consideration.

As one might expect, in the context of DoD's belief systems, those in command positions are highly concerned with performing their mission and taking care of their people. When outsourcing, cost is not the primary consideration. This is at odds with A-76 — DoD's principal outsourcing tool — that stipulates cost is the primary consideration.

Table 6.
Importance Attributed by Those in Command
Regarding Impact of Outsourcing

Which of the Following Issues Are Important Considerations when Conducting an Outsourcing Study? (Respondents in a Command Position)			
	Impact on Cost	Impact on Personnel	Impact on Mission Performance
Strongly Agree	36%	61%	89%
Agree	49%	30%	9%
Neither Agree nor Disagree	8%	5%	0%
Disagree	5%	3%	1%
Strongly Disagree	2%	2%	1%
NOTE: Total may not add to 100% due to rounding error.			

SUMMARY

Survey responses indicated a high degree of dissatisfaction with A-76 and other cost-based outsourcing initiatives. However, it should be noted the sample population was quite small and was skewed toward installation commanders, the executors of current outsourcing policies. Thirteen hundred surveys were sent out and 234 responses were received. Of these 234 responses, 111 identified themselves as being in a position of command (30 Army, 63 Air Force, and 18 Navy/Marine Corps).

The nature of the responses received indicates to us there are significant issues the Department must address. In the course of our research, we have noted DoD focuses almost exclusively on efficiency when conducting business operations. Almost no emphasis is given to devising effective business strategies or examining efficiencies in terms of a value proposition. Giving precedence to efficiency is largely a reaction to:

- unrelenting budgetary pressures,
- execution of public policy, and
- resource allocation processes.

This drive to the “bottom line,” however, assumes DoD already has an effective strategy and it merely needs to fine-tune the operation. This is a poor assumption on three counts. First, without conducting a strategic business analysis, DoD cannot be certain it has an effective strategy. Second, DoD should seek best value and not lowest cost. In other words, DoD should garner the most performance for every dollar spent rather than spending the

least amount of dollars. Finally, in complex integrated systems, aggregate and not isolated efficiencies must be the focus. By ignoring this, there is an inherent risk that tactical pursuit of cost reductions at the business unit level will drive adverse strategic outcomes.

In the post-Cold War era, defense planners have been subjected to a great deal of budgetary and political pressure to find areas of potential savings in DoD. This focus on trimming accounts and infrastructure is a

“The nature of the responses received indicates to us there are significant issues the Department must address.”

tactical not a strategic move. The focus is on efficiency. Squeezing accounts never addresses the question of strategy — are we doing the right things in the first place?

The Department of Defense must firmly establish strategic boundaries around a well-defined strategic domain. This would preclude many of the costly and difficult to reverse integration decisions that have led the Department to the point where resources applied to infrastructure vastly overshadows resources directed to core mission performance.

However, even if DoD had relied on a simple check of the Yellow Pages to see if the activity was available commercially before integrating activities over the past 45 years, the Department would likely still find itself over-integrated. It does not take a great deal of rationalization to justify any activity as being inherently governmental if the qualifying characteristic is that the function is, “so intimately related to the public interest as to mandate performance by Government employees” (Office of

Management and Budget [OMB] Circular A-76 [Revised 1999], p. 3).

We hold that the concept of “inherently governmental” should be abandoned when addressing DoD business strategy. Instead, the integration decision should revolve around whether or not integrating the activity provides the Department with a competitive advantage (or conversely, whether integrating the activity will gener-

“Operating like a business begins with an effective strategy.”

erate a strategic disadvantage). More to the point, if an organization can do a few things well or many things

poorly, what are the few things DoD should do to be effective in the performance of its mission?

Such an approach will yield a much different answer than cost-based restructuring. Our report goes beyond the mere slogan that the Department of Defense should operate more like a business. We offer a new perspective to demonstrate what operating like a business actually means. It means much more than business efficiency. It entails a focus on the productive use of resources, processes, and culture to garner a competitive advantage. Operating like a business begins with an effective strategy.

We submit that a primary focus on effectiveness entails a critical shift in perspective that is much needed within DoD.

We believe this discussion is worthwhile and provides a framework for understanding some of the vexing issues, such as outsourcing and privatization, the Defense Department currently faces and better strategies for dealing with them. There are many risks in taking this approach.

The good news is the Department and Services have already experimented successfully in management initiatives like Activity-Based Costing that are critical to managing these risks. In addition, we acknowledge the existence of significant outsourcing implementation risks. Yet, within the Services and industry in general, there are clear lessons to capture from successful and unsuccessful outsourcing efforts. The Department must look to quickly capitalize and build upon the positive aspects of these experiences.

In the final report we present our conclusions and recommendations on how DoD should better approach outsourcing and the tools necessary to successfully manage outsourcing relationships. Acknowledging the limits of our survey, one of the recommendations is for DoD to conduct additional polling to validate these results. Additionally, we recommend the Department conduct interviews in order to gauge more thoroughly the issues embodied in these responses. When asked to elaborate, many respondents elaborated in great detail about outsourcing policies. One-on-one interviews would better capture this valuable feedback.



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